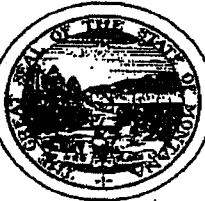


# DEPARTMENT OF NATURAL RESOURCES AND CONSERVATION



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### MEMORANDUM

To: Bill Schultz, Missoula Regional Office Manager  
Terri Eccles, Kalispell Regional Office Manager  
Terry McLaughlin, Water Rights Bureau Chief  
Kim Overcast, New Appropriations Supervisor

From: John E. Tobbs, Administrator

Re: Permitting in the open Clark Fork and Flathead basins.

Date: June 9, 2008

Over the last year-and-a-half the Missoula and Kalispell Regional Offices have been instructed to review each new water permit application on a case-by case basis relative to the Thompson Falls Lumber Company (TFLC) decision. Discussions between our technical and legal staff have been ongoing. As indicated by memorandum documenting various meetings, the case-by-case process is not proving to be effective for field staff. Added to this, the Bostwick case focuses the agency in a direction to make criteria decisions early in the process rather than at the end, in certain areas of the State.

The receipt of a letter from Avista Corporation (June 4, 2008) confirmed a direction that I have been moving toward over the last four months. That position being that the TFLC is precedent setting, but did not close the basin to further appropriations. This is the first permit application that Avista Corp. objected to under the Water Use Act in the Clark Fork basin, and the objection prevailed. It is precedent setting to the extent that the facts brought to the case by Avista Corp. proved that the 250 gallon per minute, 400 acre-feet per year, use of surface water in the lower Clark Fork would adversely affect their senior hydropower rights. Avista clarified their concerns regarding new appropriations to the Department. The lower Clark Fork and Flathead River basins remain open to appropriations.

The TFLC case specifically addresses the effects of a new surface water diversion just upstream of the City of Thompson Falls and within 10 miles of Noxon Reservoirs upper shores. As mentioned above, the facts in the case demonstrate that a diversion near the reservoir causes adverse affect. The letter from Avista Corp. identifies the specific issues with the TFLC application that concerned the objector.

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However, the letter also indicates areas where Avista, at this time, does not believe new uses will cause adverse effect. In part this may be due to the mitigating effect of storage behind Kerr Dam in Flathead Lake and behind Hungry Horse Dam. These two large storage facilities are managed based on specific rule curves and flow regimes. In other words, stream flows at Noxon Rapids are in large part managed flows (without regard to natural flow), except during high flow events. As a result, the impacts attributed to new diversions upstream of the confluence of the Clark Fork and the Flathead Rivers are diminished by the off-setting effect of storage.

For these reasons, regional offices should limit their use of the TFLC case as precedent to: new applications for surface water in the open Clark Fork River and tributaries, excluding the Flathead River and its tributaries upstream of the Flathead Indian Reservation Boundary. Again these basins are open. All appropriations must still be evaluated based on the requisite criteria, including ground water appropriations that may have an adverse effect on the ability of surface water right holders to exercise their rights.

The Department is precluded from issuing any permits within the Reservation. On-going negotiations with the Salish and Kootenai Tribes will define the availability of water in the lower Flathead Basin.

Finally, TFLC should be seen in context with the efforts the State is undertaking to seek 100,000 acre-feet of stored water in Hungry Horse Reservoir. This is a forward-looking effort but speaks to the commitment to protect all senior water rights, including hydropower. Ultimately, future water uses could have Hungry Horse storage available for mitigation water in the Clark Fork Basin.

The State constitution requires protection of senior water rights but it also recognizes the "use of all water" (Article IX, Section 3 (2), MCA). The approach outlined in this memo represents the balance of these two provisions based upon the information available. All applications must meet the 85-2-311 criteria; however, only a subset, as described above, are directly impacted by TFLC.

The Department is also issuing a new rule confirming that mitigation of surface water depletions is an acceptable method of preventing adverse affect associated with new uses. Not all water uses will fit within the sideboards that this memo provides. Either internal to a watershed, or for larger uses along the lower Clark Fork River, mitigation remains a viable method to overcome impacts to senior water right holders. This is standard operating procedure for the Department; the new rule will make it clear to the public that mitigation is a viable option.

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June 2, 2008

Mr. John Tubbs, Administrator  
Water Resources Division, Department of Natural Resources and Conservation  
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Dear Mr. Tubbs:

At your request, Avista has carefully considered the issues surrounding development of new water appropriations in areas where those developments may have an adverse affect on Avista Corporation's water rights. You made it clear during our meeting on April 4, 2008, that the department is struggling with the need to address each water permit application on a case-by-case basis and is interested in a written document from Avista that describes situations where we would most likely not object to a new water permit application.

It is important to note that the Montana Water Court conducted an evidentiary hearing on Avista's pre-1973 water rights, and Water Judge Holter issued an order that set forth those rights. Avista also holds a provisional water right permit. Throughout its nearly sixty year history of doing business in Montana, Avista has observed the water rights laws, as they apply to any other water user. Avista has never made a call on existing water rights, and has objected, due to special circumstances, to only one application for a new provisional water right permit. Unique circumstances led Avista to file and pursue an objection to the water permit application of Thompson River Lumber Company (TRL). Those circumstances are worth noting.

In 2004, TRL applied for a surface water right to divert water from the Clark Fork River for a cogeneration power plant to be operated near Thompson Falls, to which Avista objected. Hearing Examiner Charles F. Brasen of the DNRC conducted an evidentiary hearing and issued a recommended order denying the permit. In August 2006, Hearing Examiner David A. Vogler heard oral argument on TRL's exceptions to the proposed order, and he denied TRL's exceptions and issued a final order denying TRL's application. TRL did not appeal the final order.

The unique circumstances that prompted Avista to pursue this objection are:

1. TRL proposed to divert water directly upstream of Avista's Noxon Dam Reservoir. Unlike permits issued farther upstream and on tributaries, there was no question that Avista's right would be directly impacted.
2. TRL had alternative sources of water available. It appears that TRL's primary purpose in obtaining surface water was to diminish the expense associated with pumping and treating well water pursuant to a groundwater right.

3. TRL stated in its original permit application that water was available for its use, because downstream hydroelectric projects had never made a call on junior water right users. Furthermore, TRL stated in its application that it would cease using river water if downstream hydroelectric projects made a "non-selective" call. Therefore, TRL's application sought to limit downstream water rights that had priority in a manner not allowed or required by statute.
4. Additionally, it was apparent from the evidentiary hearing that TRL's expert witnesses fundamentally misunderstood the operations of Avista's Noxon Rapids Dam, which they described as a "run-of-the-river" dam. Therefore, issuance of a permit would perpetuate a mischaracterization of Avista's project and water rights.

These exceptional circumstances in total, not merely the amount of water being requested, resulted in Avista's objection. However, this objection should not necessarily be viewed as an indication of how Avista intends to deal with other permit applications. The vast majority of these applications concern tributary water at a considerable distance from Avista's projects, and involve domestic or in-stream uses of water. They are vastly different from the unique circumstances associated with TRL's application. With the exception of TRL and as stated earlier, Avista has not objected to any applications on file with DNRC.

Avista believes that the most prudent approach for DNRC, with regard to providing a means for orderly development of water in basins that are not closed to new appropriations, is to promulgate a rule that makes it clear to all applicants that an applicant may use a mitigation or aquifer recharge plan, as defined in 85-2-102, MCA, as a means to offset adverse affect. Such a rule would provide clarity to applicants as well as agency employees.

Avista is aware that the Department's interpretation of Hearing Examiner Vogler's order (denying TRL's application) has been used by the Department as a precedent to determine adverse affect. However, Avista believes that each new permit application has its own site-specific facts associated with the proposed new use, including factual considerations of the period and time of use, return flows, volume and/or flow rate, distance from other water rights, and the number and size of intervening senior water right holders who would have the right to intercept the water, before it ever reached Avista's Noxon Dam.

As a general matter, Avista reserves the right to review each provisional water right application on its own merits and to object if it concludes that an objection is necessary. However, if a new water permit application request meets either of the following criteria, it is highly unlikely that Avista would object to the issuance of a provisional water right permit:

1. The point of diversion is in the Flathead River basin (including tributaries of the Flathead River and Flathead Lake) upstream of the point where the Flathead River leaves the Flathead Reservation; or

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2. The application meets at least one of the following criteria:
  - a. The amount of water proposed to be diverted is de minimus; or
  - b. The proposed use of water is largely nonconsumptive, such as domestic use inside a home; or
  - c. An aquifer recharge or mitigation plan is developed to offset adverse impacts.

These criteria are not intended to be exclusive; we merely are providing perspectives in cases that seem clear to us are unlikely to cause any adverse effect. We hope that the foregoing is helpful, as the Department considers administrative rule changes and water permit applications, as well as the ongoing protection of all existing water rights.

Sincerely,



Steven A. Fry  
Hydro Projects Manager

C: Mary Sexton, Director  
Department of Natural Resources & Conservation